Research on the Disclosure of Internal Control Defects in Listed Companies in China

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Abstract: This paper analyzes the problems existing in the information disclosure of internal control defects of listed companies in China, and believes that there are lack of comparability of internal control defect identification standards, copying internal control evaluation system, insufficient disclosure of internal control defects, etc. Targeted improvement measures are proposed.

1. Introduction

In 2008 and 2010, the Ministry of Finance and other five ministries and commissions jointly issued the "Basic Standards for Internal Control of Enterprises" and its supporting guidelines. Since January 1, 2012, they have been implemented on the Main Board of the Shanghai Stock Exchange and the Shenzhen Stock Exchange, requiring listed companies to evaluate the internals. The effectiveness of the control, the self-evaluation report was issued, and the accounting firm was hired to audit the effectiveness of the internal control and issue an audit report. Since then, China's internal control information disclosure has entered the mandatory disclosure stage by voluntary disclosure [1]. This paper studies the disclosure of internal control defects of listed companies, points out the problems existing in the disclosure of internal control defects of listed companies, analyzes the causes of problems, and puts forward suggestions for improvement, in order to further standardize the disclosure of internal control information of listed companies and improve the disclosure of internal control information of listed companies.

2. Problems in the Disclosure of Internal Control Defects in Listed Companies

After the introduction of the basic norms and supporting guidelines for internal control, most listed companies disclosed self-evaluation reports on internal control. According to the regulations, the internal control defects were classified into major defects, important defects and general defects according to the degree of influence, and the financial disclosure was disclosed. However, the disclosure of internal control defects by listed companies in China still has problems.

The internal control evaluation report of listed companies distinguishes the quantitative standard from the qualitative standard. The quantitative standard generally uses financial indicators such as total profit, total assets, and operating income as the benchmark indicators, and sets a certain percentage of the benchmark indicators to determine the basic importance. Taking Shengda Forestry as an example, misreporting ≥1% of total assets is a major defect, 0.5% of total assets ≤ misreported <1% of total assets is an important defect, and misreporting <0.5% of total assets is an important defect, and misreporting <0.5% of total assets is a general defect. However, the benchmark indicators of the internal control importance level of different companies are inconsistent. Some companies use a single financial indicator as the benchmark for the importance of internal control defects. Some companies use multiple financial indicators as the benchmark for the importance level of internal control defects, even if they use the same the financial indicators are used as benchmark indicators, and the criteria for dividing the level of importance are also different. If the operating income is used as the benchmark, the proportion of commonly used importance levels will be 1%, 2%, 5%, etc., so that even the same size of the same industry, the division of general defects, important defects and major defects are different. The
resulting quantitative standards for internal control defects are not comparable [2].

Many supervisors have described the qualitative criteria in the internal control evaluation guidelines and audit guidelines for the identification of internal control defect qualitative standards. Taking major defects as an example, there are two common ways: one is generally defined as “one or the combination of multiple control deficiencies may result in serious violations of group control or certain economic losses.” The second is to adopt an enumerated approach “not selecting and applying accounting policies in accordance with generally accepted accounting standards, not establishing anti-fraud procedures and control measures..." Whether, the identification of qualitative standards is not specific enough and lacks pertinence."

There are fewer companies with internal control defects disclosed by listed companies, and companies that disclose defects also have insufficient descriptions of internal control deficiencies, less substantive information disclosed, and negative effects of dilution defects. In 2017, there were 101 listed companies in Sichuan province, 96 companies released self-evaluation reports, only 6 companies disclosed defects in internal control over financial reports, and 5 companies disclosed defects in internal control of non-financial reports. Describe in detail the type, impact and specific rectification of the defect. It can be seen that the number of companies that disclose internal control defects is extremely small. Excluding companies that do not have defects, more companies should not find internal control defects or be willing to disclose internal control defects [3].

3. The Reasons for the Existence of Problems in the Disclosure of Internal Control Defects

The Internal Control Evaluation Guidelines classify internal control defects into major defects, important defects and general defects. General defects refer to defects other than important defects as well as major defects. A major defect refers to a combination of one or more control defects that can easily cause a company to deviate from its control objectives. An important defect refers to a combination of multiple control defects, and the economic consequences are less severe than the consequences of major defects. At the same time, the company is required to divide the internal control defects according to the situation. The Internal Control Audit Guidelines use the enumerated methods to list four situations in which internal control may have significant internal control deficiencies.

It can be seen that although the relevant documents stipulate the identification methods of the three types of defects, they lack the detailed provisions. For the identification of general defects, major defects and important defects, the enterprise needs to combine the external environment, industry characteristics and its own situation. Therefore, according to the division of internal control understanding, each enterprise finds that the standard gap is large and lacks comparability, which also leads to insufficient detailed and specific disclosure of internal control defects.

China's listed companies lack the motivation for internal control and information disclosure. The reasons are as follows: First, although China introduced the "Basic Standards for Internal Control" in 2008, the internal control awareness of listed companies is generally weak, and the internal enterprises are not recognized. Controlling the role of sustainable development of enterprises, many companies have established various systems in accordance with the requirements of the norms, but have not been effectively implemented. The disclosure of internal control information is only a mandatory requirement of the regulatory authorities, and insufficient attention is paid to the disclosure of internal control information. Second, the disclosure of internal control information is based on the evaluation of the effectiveness of internal control. Enterprises are not willing to invest limited company resources in internal control construction and evaluation from the perspective of cost-benefit, so that they do not think it will produce much benefit. Third, due to the influence of signal transmission theory, listed companies often take the initiative to transmit information with positive impact. Relevant research shows that disclosure of internal control defects may cause negative reactions, so the amount of internal control information disclosed by management is greatly reduced [4].

At this stage, China pays more attention to the construction of the system, but fails to pay attention to the implementation of the system. In the process of implementation, there is a problem
of insufficient supervision [5]. It is difficult to give directions to the problems existing in the internal control of the enterprise, and disclose the defects of internal control. There are no violations in the violations, which reduce the quality of disclosure of internal control defects.

If participants in the capital market pay more attention to the internal control information of the enterprise, the enterprise will inevitably enhance the awareness of disclosure and improve the quality of disclosure of internal control defects. However, the majority of investors and creditors in China pay more attention to the financial statements and profitability, solvency and other financial information disclosed by the company, ignoring the internal control information related to the sustainable development of the enterprise, and the internal control information lacks market demand [6].

4. Measures to Improve the Disclosure of Internal Control Defects of Listed Companies

Internal Control Defects Identification Standards Prerequisites and warranties for the disclosure of high quality internal control defects. The academic community should actively carry out research on the internal control defect identification standards. The regulatory authorities should improve the internal control evaluation system, formulate a set of scientific defect identification standards and evaluation standards, and refine the disclosure requirements for internal control defect identification standards. Only then can The right to reduce the arbitrage of internal control defects of listed companies, the information disclosed is comparable, and the internal control can be evaluated and audited.

It is the key to improve the consciousness of the internal control defects of listed companies and improve the internal governance structure of the company. First, improve the internal control environment, enhance the company's internal control concept, and let listed companies realize that improving internal control and revealing high-quality internal control information can reduce the capital cost of enterprises and attract the attention of investors, thus enabling enterprises to be more conscious. Conduct internal control evaluations and disclosure of defects. Second, further clarify the disclosure subject of internal control defects. The "Basic Standards for Internal Control" stipulates that the board of directors is the subject of information disclosure of the company's internal control information. The board of supervisors under the board of supervisors and the board of directors has supervisory functions for internal control, and the manager is responsible for leading the daily operation of the company's internal control. The “Guidelines for Enterprise Internal Control Evaluation” requires the board of directors of the company to be responsible for the authenticity of the internal control evaluation report. Therefore, the listed company should further clarify and strengthen the responsibility of the board of directors, the board of supervisors, the management and the audit committee for the company's internal control supervision and related information disclosure, and improve the quality of internal control defect disclosure [7].

To establish and improve the legal and regulatory system related to the company's internal control information disclosure, if it fails to truthfully disclose the internal control defects, or conceal important defects or major defects, it is necessary to investigate the responsibility of the listed company and implement the responsibility to the individual. Further clarify the penalties for non-compliance with the disclosure of internal control defects, and penalize companies that do not disclose or disclose non-conformity and false disclosures [8]. In addition, the audit firm should strengthen the audit of the internal control of the enterprise, improve the quality of internal control audit, and play the supervisory role of the firm in the internal control construction and information disclosure of the firm.

On the one hand, regulators can publicize the importance of internal control information through radio, newspapers and online, or use live demonstrations to enable individual investors to have an intuitive experience of how to evaluate and apply disclosure flaws, and to enhance individual investors. The purpose of the internal control information needs, and finally enhance the enthusiasm and initiative of the internal control information disclosure. On the other hand, in general, institutional investors understand that the demand for internal control of enterprises is more intense. At this stage of China, the size of institutional investors is still far behind that of developed
countries. It can be actively developed by institutional investors. Become an influential information consumer on the market [9].

5. Conclusion

Through research, it is found that after the publication of China's "Basic Standards for Internal Control of Enterprises" and its supporting guidelines, most listed companies have released self-evaluation reports on internal control, and disclosed defect identification standards and internal control defects and rectification measures in the evaluation report. However, there are problems such as vague internal control defect identification standards and inadequate disclosure of internal control defects. This paper believes that detailed internal control defect identification standards and disclosure standards should be formulated, the company's internal governance structure should be improved, and the supervision mechanism for internal control defect disclosure should be improved. Measures such as effective control of internal control defect information to further improve the quality of internal control defect disclosure.

References


